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INTERNAL AUDIT MANUAL(U) DEPARTMENT OF DEFENSE  
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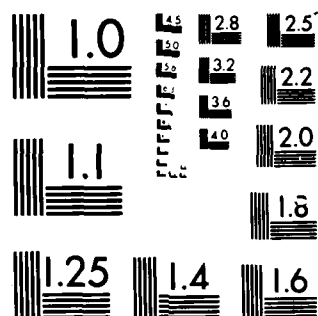
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DEPARTMENT OF DEFENSE

AD-A163 595

# INTERNAL AUDIT MANUAL

OFFICE OF  
INSPECTOR GENERAL

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NOVEMBER 1985

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DEPARTMENT OF DEFENSE  
INSPECTOR GENERAL  
WASHINGTON, D.C. 20301

FOREWORD

One of my highest priorities as the Defense Inspector General is to encourage the effective use of DoD audit, investigative and inspection resources. Cooperation is one of the most important ways to achieve this goal because it can help eliminate duplication of audit work and increase sharing of audit techniques and results. I believe uniformity of audit policy and of certain operating procedures can facilitate the free and open exchange of ideas which is so essential to effective cooperation. Put simply, we can communicate better if we all speak the same language.

The purpose of this manual is to establish uniform policies and procedures so we will all be able to speak the same language. In addition, it is designed to help DoD auditors and internal audit and internal review organizations comply with standards, policies, and procedures promulgated by the Congress, the Comptroller General of the United States, the Office of Management and Budget, the President's Council on Integrity and Efficiency, and the Department of Defense.

This manual is issued under the authority of DoD Directive 7600.7, "DoD Internal Audit Standards, Policies, and Procedures," October 31, 1983. It applies to the Office of the Secretary of Defense (OSD), the Military Departments, the Organization of the Joint Chiefs of Staff, the Unified and Specified Commands, and the Defense Agencies (hereafter referred to collectively as "DoD Components").

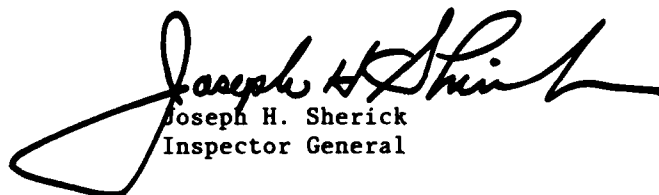
The manual chapters are effective when published. However, because certain provisions may require major changes in the existing policies and procedures of the DoD internal audit and internal review organizations, each organization will be allowed a reasonable period of time to make appropriate revisions in their implementing guidance.

The policy contained in the internal audit policy memoranda issued by the Inspector General, Department of Defense (IG, DoD) will be incorporated into this manual. Each policy memorandum will be rescinded when the appropriate manual chapter is published.

Forward recommended changes to this manual through channels to:

Office of the Assistant Inspector General  
for Audit Policy and Oversight  
Office of the Inspector General  
Department of Defense  
Room 1E463, Pentagon  
Washington, D.C. 20301

DoD Components may obtain copies of this manual through their own publication channels. Other Federal agencies and the public may obtain copies from the U.S. Department of Commerce, National Technical Information Service, 5285 Port Royal Road, Springfield, Virginia 22161.

  
Joseph H. Sherick  
Inspector General



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DOD INTERNAL AUDIT MANUAL

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- (a) Public Law 95-452, "Inspector General Act of 1978," as amended, October 12, 1978
- (b) Office of Management and Budget Circular A-73, "Audit of Federal Operations and Programs," June 20, 1983
- (c) Comptroller General of the United States, "Standards for Audit of Governmental Organizations, Programs, Activities and Functions," February 27, 1981
- (d) DoD Directive 7600.7, "DoD Internal Audit Standards, Policies and Procedures," October 31, 1983
- (e) Institute of Internal Auditors, "Standards for the Professional Practice of Internal Auditing," 1978
- (f) President's Council on Integrity and Efficiency, "Quality Standards for Federal Offices of Inspector General," January 25, 1984
- (g) DoD Directive 5000.19, "Policies for the Management and Control of Information Requirements," March 12, 1976
- (h) DoD Directive 7600.2, "Audit Policies," January 10, 1985
- (i) Inspector General, Department of Defense, Contract Audit Policy Memorandum No. 1, "Relationships Between Contract and Internal Audit Organizations," December 21, 1983
- (j) Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982," September 8, 1982
- (k) Office of Management and Budget Circular A-123, "Internal Control Systems," revised August 16, 1983
- (l) DoD Directive 5010.38, "Internal Management Control Program," July 16, 1984
- (m) Office of Management and Budget, "Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government," December 1982
- (n) Comptroller General of the United States, "Standards for Internal Controls in the Federal Government, June 1, 1983
- (o) DoD Directive 5106.1, "Inspector General of the Department of Defense," March 14, 1983
- (p) DoD Instruction 7600.3, "Internal Audit in the Department of Defense," January 4, 1974

REFERENCES (continued)

- (q) DoD Instruction 7600.5, "Internal Audit Staff Development Programs; Qualification and Supervisory Structure," January 4, 1974
- (r) DoD Instruction 7600.6, "Audit of Nonappropriated Funds and Related Activities," January 4, 1974

## CHAPTER 1

### GENERAL

#### A. PURPOSE

This manual provides general guidance on the standards and policies to be followed by DoD internal auditors in the performance of their audit mission, and prescribes procedures, where applicable, to ensure uniformity of implementation.

#### B. APPLICABILITY

1. This manual applies to all DoD internal audit and internal review organizations, including nonappropriated fund audit organizations (hereafter referred to collectively as "internal audit organizations").

2. Certain portions of this manual do not apply to internal review and nonappropriated fund audit organizations. Each chapter will indicate the applicability of the provisions of that chapter to all types of audit organizations.

#### C. BACKGROUND

1. The Inspector General Act of 1978, as amended, (reference (a)) and the Office of Management and Budget (OMB) Circular A-73 (reference (b)), require the IG, DoD, to provide policy direction for audits of the programs and operations of the Department of Defense. In carrying out these policy formulation responsibilities, the IG, DoD, also is required to ensure that DoD audits comply with standards established by the Comptroller General of the United States (reference (c)).

2. The DoD Directive 7600.7 (reference (d)) requires the IG, DoD, to (a) develop uniform standards, policies, and procedures to improve the efficiency and effectiveness of DoD internal audit activities and (b) provide a consistent basis for measuring the quality and effectiveness of internal audit operations. As part of these responsibilities, the IG, DoD, is responsible for developing, publishing, and maintaining an internal audit manual setting forth the uniform standards, policies, and procedures. In addition, the regulation requires the DoD Components to develop the detailed procedures required to implement the internal audit policy manual.

#### D. EFFECTIVE DATE

1. The chapters in this manual are effective when issued. However, because certain provisions of this manual may require major changes in the existing policies and procedures of the DoD internal audit organizations, the individual organizations will be allowed a reasonable period of time to make appropriate revisions in their implementing guidance.

2. All deviations from the standards in the manual must be approved by the Assistant Inspector General for Audit Policy and Oversight, Office of the Inspector General, Department of Defense (AIG-APO, OIG, DoD).

E. OBJECTIVE.

The objective of the DoD Internal Audit Policy Manual is to provide guidance that will help ensure that quality audit service is provided systematically to all DoD organizations, programs, activities, and functions. Normally, policy objectives shall be stated and followed by suggested procedures. In such cases, the DoD internal audit organizations will be allowed to use alternative procedures as long as the policy objectives are met. However, when a high degree of uniformity is needed, mandatory procedures will be prescribed specifically and alternate procedures may not be used without advance approval by the AIG-APO, OIG, DoD. Unless a specific implementation date is prescribed, objectives are to be met fully and mandatory provisions fully implemented within 1 year of final publication.

CHAPTER 2DOD INTERNAL AUDITING STANDARDSA. PURPOSE

The purpose of this chapter is to prescribe the auditing standards that shall be followed by DoD internal audit organizations and auditors in the management and performance of auditing activities.

B. APPLICABILITY

The provisions of this chapter are mandatory for all DoD internal audit and internal review organizations, including nonappropriated fund audit organizations (hereafter referred to collectively as "internal audit organizations").

C. BACKGROUND

1. The level of acceptance and confidence in audit work by management and external bodies is largely dependent upon the quality and reliability of such work. Properly developed standards provide criteria by which the quality and efficiency of an audit organization may be evaluated and measured. The existence and use of standards by audit organizations distinguish these organizations from other DoD review and oversight activities. The Inspector General Act of 1978, as amended (reference (a)), requires all DoD internal audit organizations to adhere to auditing standards issued by the Comptroller General of the United States (reference (c)). These standards relate to the scope and quality of audit efforts and to the characteristics of professional and meaningful audit reports. The statements on auditing standards and other pronouncements issued by the American Institute of Certified Public Accountants are incorporated into reference (a) unless specifically excluded by a formal announcement from the General Accounting Office (GAO).

2. The Institute of Internal Auditors (IIA) and the President's Council on Integrity and Efficiency (PCIE) also have promulgated standards (references (e) and (f)) applicable to audit activities. The IIA and PCIE standards are compatible with those issued by the Comptroller General of the United States (reference (c)). While reference (c) deals primarily with the performance of individual audit projects, references (e) and (f) provide guidelines for the management of both audit projects and audit organizations.

3. Office of Management and Budget Circular A-73 (reference (b)) also provides guidance applicable to DoD internal audit organizations. Reference (b) concentrates on the areas of organization and staffing of audit activities, determination of audit priorities, formulation of audit plans, and coordination of audit work.

#### D. DOD AUDITING STANDARDS

The auditing standards to be followed by DoD internal audit organizations and auditors are a compilation of auditing standards issued by the OMB, Comptroller General, IIA and PCIE (references (b), (c), (e), and (f)). The DoD auditing standards are comprised of 6 general standards and 34 specific standards. The six general standards are as follows:

100 INDEPENDENCE - The internal audit organization and the individual auditors must be free from personal, external, or organizational impairments and consistently shall maintain an independent attitude and appearance.

110 Personal Impairments - In some circumstances, auditors cannot be impartial because of their views or personal situation. While these impairments apply to individual auditors, they also may apply to the internal audit organization. These circumstances include, but are not limited to, the following:

1. Official, professional, personal, or financial relationships that may cause the auditor to limit the extent of the inquiry, to limit disclosure, or to weaken audit findings in any way.
2. Preconceived ideas about individuals, groups, organizations, or objectives of a particular program that could bias the audit.
3. Previous involvement in a decisionmaking or management capacity that would affect current operations of the entity or program being audited.
4. Biases, including those induced by political or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of Government.
5. Subsequent performance of an audit by the same individual who, for example, previously had approved invoices, payrolls, claims, and other proposed payments.
6. Subsequent performance of an audit by the same individual who maintained the official accounting records.
7. Financial interests, direct or substantially indirect, in the audited entity or program.

120 External Impairments - Factors external to the internal audit organization can restrict the audit or interfere with the auditor's ability to form independent and objective opinions and conclusions. For example, under the following conditions, an audit will be affected adversely and the auditor will not have complete freedom to make an independent and objective judgment:

1. Undue interference in the recruitment and assignment of audit personnel.
2. Undue restrictions on funds or other resources dedicated to the internal audit organization that could prevent the auditors from performing essential work.
3. Authority to overrule or to unduly influence the auditor's judgment as to selection of what is to be audited, determination of the scope and timing of work or approach to be used, content of any resulting report, or resolution of audit findings.
4. Influences that jeopardize the auditor's continued employment for reasons other than competency or the need for audit services.
5. Interference with access to all records, reports, audits, reviews, documents, papers, recommendations, or other material needed to carry out the audit or denial of opportunity to obtain explanations from officials and employees.
6. Political pressures that affect the selection of areas for audit, the performance of those audits, and the reporting of conclusions objectively without fear of censure.

130 Scope Impairments - When factors external to the internal audit organization and the auditor restrict the audit or interfere with the auditor's ability to form objective opinions and conclusions, the auditor shall attempt to remove the limitation or, failing that, appropriately qualify the resulting audit report.

140 Organizational Placement - The DoD internal audit organizations shall report to the head or deputy head of the agency and shall be organizationally located outside the staff or line management function of the activities or functions under audit.

150 Objectivity - Auditors shall be objective in performing audits.

1. Objectivity is an independent mental attitude which auditors shall maintain in performing audits. Auditors are not to subordinate their judgment on audit matters to that of others.



2. The auditor's objectivity is not adversely affected when the auditor recommends standards of control for systems or reviews procedures before they are implemented. Designing, installing and operating systems are not audit functions. Also, the drafting of procedures for systems is not an audit function. Performing such activities is presumed to impair audit objectivity.

200 PROFESSIONAL PROFICIENCY - Professional proficiency is the responsibility of the internal audit organization and each auditor. The internal audit organization shall assign to each audit those persons who collectively possess the necessary knowledge, skills, and disciplines to conduct the audit properly.

210 Due Professional Care - Due professional care is to be used in conducting the audit and in preparing the related reports.

1. The internal audit organization and the auditor are responsible for employing professional standards in auditing Government organizations, programs, activities, and functions.
2. Due professional care calls for the application of the care and skill expected of a reasonably prudent and competent auditor in the same or similar circumstances. Professional care should, therefore, be appropriate to the complexities of the audit being performed. In exercising due professional care, auditors shall be alert to the possibility of intentional wrongdoing, errors and omissions, inefficiency, waste, ineffectiveness, and conflicts of interest. They also shall be alert to those conditions and activities where irregularities are most likely to occur. In addition, they shall identify inadequate controls and recommend improvements to promote compliance with acceptable procedures and practices.
3. Due care implies reasonable care and competence, not infallibility or extraordinary performance. Due care requires the auditor to conduct examinations and verification to a reasonable extent, but does not require detailed audits of all transactions. Accordingly, the auditor cannot give absolute assurance that noncompliance or irregularities do not exist. Nevertheless, the possibility of material irregularities or noncompliance shall be considered whenever the auditor undertakes an auditing assignment.
4. When an auditor suspects fraud or other illegal acts, the appropriate DoD criminal investigative organization shall be informed.
5. Exercising due professional care means using good judgment in choosing tests and procedures and in preparing reports. To this end, the auditor shall consider the following:
  - a. Extent of audit work needed to achieve audit objectives.

- b. Relative materiality or significance of matters to which audit procedures are applied.
- c. Adequacy and effectiveness of internal controls.
- d. Cost of auditing in relation to potential benefits.

220 Auditor Qualifications - Auditors shall possess the knowledge, skills, and disciplines essential to the performance of audits. Each auditor shall possess certain knowledge and skills as follows

- 1. Proficiency in applying internal auditing standards, procedures, and techniques is required in performing audits. Proficiency means the ability to apply knowledge to situations likely to be encountered and to deal with them without extensive recourse to technical research and assistance.
- 2. Proficiency in accounting principles and techniques is required for auditors who work extensively with financial records and reports.
- 3. An understanding of management principles is required to recognize and evaluate the materiality and significance of deviations from good business practices. An understanding means the ability to apply broad knowledge to situations likely to be encountered, to recognize significant deviations, and to be able to carry out the research necessary to arrive at reasonable solutions.
- 4. An appreciation is required of the fundamentals of such subjects as accounting, economics, quantitative methods, and computerized information systems.
- 5. A knowledge of directives and other issuances from GAO, OMB, Department of Defense, the Congress, or other authoritative bodies.
- 6. A working familiarity with the organizations, programs, activities, and functions of each major DoD Component subject to audit, in sufficient depth to knowledgeably assess that Component's mission accomplishment and to identify problems to the degree required for a particular task or set of duties.
- 7. A knowledge of Government policies, requirements, and guidelines related to a particular task.
- 8. Managerial skills for supervisors and team leaders.

230 Human Relations and Communications - Auditors shall be skilled in dealing with people and in communicating effectively.

1. Auditors shall understand human relations and maintain satisfactory relationships with auditees.
2. Auditors shall be skilled in oral and written communications so that they can convey clearly and effectively such matters as audit objectives, evaluations, conclusions, and recommendations.

240 Continuing Education - Auditors shall maintain their technical competence through continuing education. Auditors are responsible for continuing their education to maintain their proficiency. They should keep informed about improvements and current developments in auditing standards, procedures, and techniques. Continuing education may be obtained through membership and participation in professional societies; attendance at seminars, college courses, and Federal and in-house training programs; and participation in research projects.

250 Compliance with Standards of Conduct - Auditors shall comply with professional standards of conduct. Auditors shall maintain high standards of honesty, objectivity, diligence and loyalty in the performance of their work.

300 SCOPE OF AUDIT WORK - The scope of each audit shall include an evaluation of the adequacy and effectiveness of the organization's system of internal accounting and administrative controls and of the quality of performance in carrying out assigned responsibilities.

310 Reliability and Integrity of Information - Auditors shall review the reliability and integrity of financial operating information and the means used to identify, measure, classify, and report such information. Information systems provide data for decision-making, control, and compliance with external requirements. Therefore, auditors shall examine information systems and, as appropriate, ascertain whether the following apply:

1. Financial and operating records and reports contain accurate, reliable, timely, complete, and useful information.
2. Controls over record keeping and reporting are adequate and effective.

320 Compliance with Policies, Plans, Procedures, Laws, and Regulations - Auditors shall review the systems established to ensure compliance with those policies, plans, procedures, laws and regulations that could have a significant impact on operations and reports, and should determine whether the organization is in compliance.

1. Management is responsible for establishing the systems designed to ensure compliance with such requirements as policies, plans, procedures, and applicable law and regulations. Auditors are responsible for determining whether the systems are adequate and effective and whether the activities audited are complying with the appropriate requirements.
2. The auditor shall determine whether the financial statements of an audit entity fairly present the financial position and the results of financial operations in accordance with accounting principles and standards prescribed by the Comptroller General.

330 Safeguarding of Assets - Auditors shall review the means of safeguarding assets and, as appropriate, verify the existence of such assets.

1. Auditors shall review the means used to safeguard assets from various types of losses, such as those resulting from theft, fire, improper or illegal activities, and exposure to the elements.
2. Auditors, when verifying the existence of assets, shall use appropriate audit procedures.

340 Economical and Efficient Use of Resources - Auditors shall appraise the economy and efficiency with which resources are managed.

1. Management is responsible for setting operating standards to measure an entity's economical and efficient use of resources. Auditors are responsible for determining the following:
  - a. Whether operating standards have been established for measuring economy and efficiency.
  - b. Whether established operating standards are understood and are being met.
  - c. Whether deviations from operating standards are identified, analyzed, and communicated to those responsible for corrective action.
  - d. Whether corrective action has been taken.
2. Audits related to the economical and efficient use of resources shall identify the following conditions:
  - a. Underutilized facilities.
  - b. Nonproductive work.
  - c. Procedures that are not cost effective.
  - d. Overstaffing and understaffing.
  - e. Unneeded or costly procurements.

350 Accomplishment of Established Objectives and Goals for Operations and Programs - Auditors shall review operations and programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned. Management is responsible for establishing operating or program objectives and goals, developing and implementing control procedures, and accomplishing desired operating or program results. The auditor shall determine whether the desired results or benefits are being achieved and whether the entity has considered alternatives that might yield desired results at a lower cost.

400 PERFORMANCE OF AUDIT WORK - The auditor is responsible for planning and conducting the audit assignment, subject to supervisory review and approval.

410 Planning the Audit - Auditors shall plan each audit. Planning shall be documented and include the following:

1. Establishment of audit objectives and scope of work.
2. Background information about the activities to be audited.
3. Resources necessary to perform the audit.
4. Communication with all who need to know about the audit.
5. On-site surveys to become familiar with the activities and controls to be audited, to identify areas for audit emphasis and to invite auditee comments and suggestions.
6. Determination of how, when, and to whom audit results will be communicated.
7. Approval of the audit work plan.
8. Coordination with other Government auditors, when appropriate, including work already done and other work that may be intended in the future.

420 Audit Program - A written audit program is essential to conducting audits efficiently and effectively and shall be prepared for each audit. The audit program generally shall include the following information:

1. Introduction and background.
2. Purpose and scope of audit.
3. Objectives of the audit.

4. Definition of terms.
5. Special instructions.
6. Audit procedures.
7. Format and general content of the report to be issued.

430 Supervision - The internal audit organization shall ensure that audits are supervised properly. Supervision shall be exercised at each level of the internal audit organization to provide quality control over audit assignments.

1. Supervision is a continuing process, beginning with planning and ending with the preparation of the final audit report.
2. Supervision includes the following:
  - a. Providing suitable instructions to subordinates at the beginning of the audit and approving the audit program.
  - b. Seeing that the approved audit program is carried out, unless deviations are both justified and authorized.
  - c. Ensuring that the audit is performed in conformance with professional auditing standards.
  - d. Determining that audit working papers adequately support the audit findings, conclusions, and reports.
  - e. Ensuring that audit reports are accurate, objective, clear, concise, constructive, and timely.
  - f. Providing that the work assignments are commensurate with the abilities of the assigned staff.
  - g. Determining that audit objectives are being met.
3. Supervision includes sufficient interim checks of audit work, to determine whether audit projects are on schedule and are being executed in accordance with plans, so that necessary adjustments can be made.
4. Appropriate evidence of supervision shall be documented and retained.
5. The extent of supervision required will depend on the proficiency of the auditors and the difficulty of the audit assignment.

6. All auditing assignments, whether performed by or for the audit organization, remain the responsibility of the head of the internal audit organization.

440 Examining and Evaluating Information - Auditors shall collect, analyze, interpret, and document information to support the audit results.

1. Information shall be collected on all matters related to the audit objectives and scope of work.
2. Information shall be sufficient, competent, and relevant, to provide a sound basis for audit findings and recommendations. "Sufficient" information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the auditor. "Competent" information is reliable and the best attainable through the use of appropriate audit techniques. "Relevant" information supports audit findings and recommendations and is consistent with the objectives for the audit.
3. Audit procedures, including the testing and sampling techniques employed, shall be selected in advance, when practicable, and expanded or altered if circumstances warrant.
4. The process of collecting, analyzing, interpreting, and documenting information shall be supervised, to provide reasonable assurance that the auditor's objectivity is maintained and that audit goals are met.
5. Working papers that document the audit shall be prepared by the auditor and reviewed by audit supervisory personnel. These working papers shall record the information obtained and the analyses made, and shall support the bases for the findings and recommendations to be reported. The working papers shall be complete, accurate, clear, understandable, legible, neat and contain relevant information.

450 Internal Controls - During the audit, a study and evaluation shall be made of the internal control system (accounting and administrative controls) applicable to the organization, program, activity, or function under audit.

460 Auditing of Computer-Based Systems - The auditor shall perform the following:

1. Review general controls in data processing systems, to determine whether (a) the controls have been designed according to management direction and known legal requirements, and (b) the controls are operating effectively to provide reliability of, and security over, the data being processed.

2. Review application controls of installed data processing applications upon which the auditor is relying, to assess their reliability in processing data in a timely, accurate, and complete manner.
- 470 Fraud, Abuse, and Illegal Acts - Auditors shall be alert to situations or transactions that could be indicative of fraud, abuse, and illegal expenditures and acts, and if such evidence exists, extend audit steps and procedures to identify the effect on the entity's financial statements, operations, or programs.
- 480 Audit Followup - Auditors shall follow up on a selective basis to ascertain that appropriate corrective action was taken on recommendations in Department of Defense and GAO audit reports.
- 500 REPORTING - Auditors shall report the results of their audit work in writing.
- 510 Form - Written reports are necessary to (a) communicate the results of audits to officials at all levels of Government, (b) make the findings and recommendations less susceptible to misunderstanding, (c) make the findings available for public inspection, and (d) facilitate followup to determine whether appropriate corrective measures have been taken.
- 520 Distribution - Written audit reports are to be submitted to the appropriate officials of the organization audited and to the appropriate officials of the organizations requiring or arranging for the audits, unless legal restrictions or ethical considerations prevent it. Copies of the reports also shall be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others authorized to receive such reports. Unless restricted by law or regulation, copies shall be made available for public inspection.
- 530 Timeliness - Reports shall be issued promptly to make the information available for timely use by management and legislative officials and to permit prompt initiation of following action. If applicable reports are to be issued on or before the date specified by regulation or other special arrangement.
- 540 Report Contents - The audit report shall include the following:
1. A description of the scope and objectives of the audit and background information.
  2. A description of when the audit was performed and the period covered by the audit.
  3. A statement that the audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.



4. A statement on the internal controls evaluated and description of material weaknesses found in the internal control system (accounting and administrative controls).
5. A specific conclusion on each of the stated audit objectives.
6. A copy of any financial statements reviewed, an opinion on the financial statements, and, when appropriate, a statement on any informative disclosures included in the financial statements (applies to financial and compliance audits as defined by the Comptroller General of the United States).
7. Photos, charts, graphs, attachments, and exhibits when they contribute to the clarity of the audit report.
8. Significant instances of noncompliance and instances or indications of fraud, abuse, or illegal acts found during, or in connection with, the audit. However, fraud or illegal acts shall be covered in a separate report, thus permitting the overall report to be released to the public.
9. Audit findings that contain each of the following elements:
  - a. Criteria - The standards, measures, or expectations used in making the evaluation or verification (what should be).
  - b. Condition - The factual evidence that the auditor found in the course of the examination (what is).
  - c. Cause - The reason for the difference between the expected and actual conditions (why it happened).
  - d. Effect - The risk or exposure of management because the condition is not the same as the criteria (the impact of the difference).
10. Specific and realistic recommendations for actions to improve problem areas noted in the audit and to improve operations.
11. Pertinent views of responsible management officials concerning the auditors' findings, conclusions, and recommendations. Their views shall be obtained in writing. Management's written comments may be included as an appendix to the report or presented in the body of the report.

12. If the auditors disagree with management's views on the audit recommendations, the audit report shall state both positions and the reasons for disagreement.
13. A description of noteworthy accomplishments, particularly when management improvements in one area may be applicable elsewhere.
14. An evaluation of any corrective actions taken by management in response to recommendations in prior audits.
15. A listing of any issues and questions needing further study and consideration.
16. A statement as to whether any pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information shall be described, and the law or other basis under which it is withheld shall be stated. If a separate report was issued containing this information, it shall be indicated in the report.

550 Report Presentation - The audit report shall conform to the following guidelines:

1. Present factual data accurately and fairly. Include only information, findings, and conclusions that are supported adequately by sufficient evidence in the auditors' working papers.
2. Present findings and conclusions in a convincing manner, distinguishing clearly between facts and conclusions.
3. Be objective, unbiased, and free from distortion.
4. Be written in language as clear and simple as the subject matter permits.
5. Be concise but, at the same time, clear enough to be understood by users.
6. Place primary emphasis on improvement rather than on criticism of the past. Critical comments shall be presented in a balanced perspective, considering any unusual difficulties or circumstances faced by the operating officials concerned.

600 MANAGEMENT OF INTERNAL AUDIT ORGANIZATION - The head of the internal audit organization is responsible for properly managing the organization so that audit work fulfills the general purposes and responsibilities set forth in law or approved by the head or deputy head of the agency; resources of the internal audit organization are employed efficiently and effectively; and the audit work conforms to DoD auditing standards, policies, and procedures.

610 Organization - The head of the internal audit organization is responsible for properly organizing the office to help ensure that the resources of the internal audit organization are deployed efficiently and effectively to fulfill the organization's general purposes and responsibilities.

1. The organizational structure shall foster coordinated, balanced, and integrated accomplishment of the organization's mission, goals, and objectives.
2. Recruiting, staffing, and training shall support the mission and organizational structure; the organization should not be structured around available skills. Full advantage shall be taken of those skills that are available.
3. The internal audit organization shall reflect the unique audit need of its own agency. Whether this is done by function, by parallel structure, or by some combination of both, the way in which each office is organized should simplify, and not complicate, the ability of audit personnel to review agency programs and operations.

620 Policies and Procedures - The head of the internal audit organization shall provide written policies and procedures to guide the audit staff. The form and content of written policies and procedures shall be appropriate to the size and structure of the internal audit organization and the complexity of its work. Formal administrative and technical audit manuals may not be needed by all internal audit organizations. A small internal audit organization may be managed informally. In a large internal audit organization, more formal and comprehensive policies and procedures are essential to guide the audit staff in the consistent compliance with the organization's standards of performance.

630 Scope of Responsibility - Each internal audit organization shall maintain records of its audit universe that identify the organizations, programs, activities, functions and systems subject to audit.

640 Determination of Audit Priorities - Each internal audit organization shall review periodically its audit universe and determine the coverage, frequency, and priority of audit required for each. The review shall include consideration of the following factors:

1. Statutory and regulatory requirements.
2. Adequacy of internal accounting and administrative control systems as indicated by vulnerability assessments and internal control reviews.
3. Newness, changed conditions, or sensitivity of the organization, program activity, or function.

4. Current and potential dollar magnitude.
5. Extent of Federal participation, in terms of resources or regulatory authority.
6. Management needs to be met, including key management decision dates, as developed in consultation with the responsible program officials and senior management.
7. Prior audit experience.
8. Timeliness, reliability, and scope of audits performed by others.
9. Results of other evaluations, such as inspections, program reviews, etc.
10. Availability of audit resources.

650 Planning - Each internal audit organization shall establish plans to carry out its responsibilities.

1. The planning process shall include the following:
  - a. Establishment of goals and objectives.
  - b. Formulation of audit plans.
  - c. Assessment of accomplishments.
2. Long and short term goals and objectives should be established for the internal audit organization. The goals and objectives should be achievable; included in written operating plans and budgets; and accompanied by measurement criteria and target dates for accomplishment.
3. The internal audit organization shall prepare an annual audit plan. The plan shall be flexible and adjusted, as necessary, to provide for audit coverage of unforeseen priorities. The head or deputy head of the agency shall review the plan upon completion. At a minimum, such plans shall identify the programs and operations selected for audit and define the following for each:
  - a. Specific reasons for the selection.
  - b. Overall audit objective.
  - c. Locations to be audited.
  - d. Organization that will perform the audit.
  - e. Staff days and other resources needed to perform the audit.
  - f. Anticipated benefits to be obtained from the audit.
4. The internal audit organization shall assess its results and accomplishments. To conduct such evaluations, the internal audit organization shall develop and maintain a data base that includes, at a minimum the following: a history of past efforts

and results to show prior performance, a planning process to show expected performance, and a management information system to show actual performance and results. The data base shall be developed in accordance with the policies of DoD Directive 5000.19, "Policies for the Management and Control of Information Requirements" (reference (g)). The audit organization should assess realistically the information in the data base to identify shortfalls in performance, improve operations in the future, determine whether goals and objectives are reasonable, and affix accountability for results.

660 Coordination - The internal audit organization shall coordinate its activities internally and with other components of Government to ensure effective use of available resources.

1. In planning work to be performed, the internal audit organization shall coordinate with agency management to ensure management needs are considered appropriately.
2. The internal audit organization shall minimize unnecessary duplication of audit work by coordinating the nature and scope of their audits and reviews with other DoD audit, investigation, and inspection groups.
3. Audit plans shall be exchanged among DoD internal audit organizations. Also, the internal audit organization shall meet with the appropriate GAO officials to exchange and discuss tentative audit plans for the next fiscal year. If overlapping or duplicative coverage is indicated, every effort shall be made to resolve it.
4. Upon beginning an audit, the audit staff shall seek information concerning other audits and reviews that have been performed of that activity or program.
5. The audit staff shall be alert to situations where problems are identified that may affect other DoD Components or Federal agencies. When such situations arise, the internal audit organization shall coordinate with others involved so that, where appropriate, one audit may be performed to fulfill the requirements of all.

670 Internal Audit Organization Qualifications - The internal audit organization shall possess or obtain the knowledge, skills, and disciplines needed to carry out its audit responsibilities.

1. The internal audit organization shall assess the skills of staff on board, determine the extent to which these skills match requirements, and develop a plan to address the skills that are deficient.

2. The audit staff collectively must possess the knowledge, skill, discipline, and experience essential to the practice of the auditing profession. These attributes include proficiency in applying auditing standards, procedures, and techniques.
3. The internal audit organization shall have employees or use outside experts who are qualified in the disciplines needed to meet audit responsibilities. The disciplines include accounting, budgeting, statistics, computer systems, engineering, medicine, law, etc. Each member of the internal audit organization, however, need not be qualified in all of these disciplines.

680 Personnel Management and Development - The internal audit organization shall establish a program for selecting and developing its human resources. The program shall provide for the following:

1. Selection of qualified and competent individuals.
2. Training and continuing educational opportunities for each staff member.
3. Appraisal of each auditor's performance at least annually.
4. Retention and promotion of highly skilled personnel to senior management positions.
5. Counseling to auditors on their performance and professional development.

690 Quality Assurance - Each internal audit organization shall establish and maintain a quality assurance program to ensure that work performed adheres to DoD auditing standards, policies, and procedures; conforms to internal regulations; and is carried out economically, efficiently, and effectively.

1. A quality assurance program shall include the following elements:
  - a. Supervision.
  - b. Internal reviews.
  - c. External reviews.
2. Supervision of the work of auditors shall be carried out continually to ensure conformance with auditing standards, organization policies and procedures, and audit programs.
3. Internal reviews shall be performed periodically by members of the audit staff to appraise the quality of the audit work performed. These reviews shall be performed in the same manner as any other internal audit.

4. External reviews shall be performed to appraise the quality of the internal audit organization's operations. These reviews shall be performed using guidelines published by the Office of the Inspector General, Department of Defense. Such reviews shall be conducted at least once every 3 years. Unless otherwise directed, the Office of the Assistant Inspector General for Audit Policy and Oversight shall conduct the reviews of the DoD central internal audit agencies and they, in turn, shall conduct reviews of their component's internal review or military exchange audit organizations. On completion of the review, a formal written report shall be issued. The report shall express an opinion as to the organization's compliance with the DoD auditing standards and, as appropriate, shall include recommendations for improvement.

CHAPTER 6  
COORDINATING AUDIT ACTIVITIES

A. PURPOSE

This chapter prescribes policy and suggests procedures for coordinating audit activities and exchanging audit results.

B. APPLICABILITY

1. The standards and policies prescribed in sections C and D which follow are mandatory for all DoD internal audit, internal review and military exchange audit activities (hereafter referred to collectively as "DoD internal audit organizations"). The provisions of sections E through L are not mandatory steps, but are suggested guidelines for accomplishing coordination policies. Certain procedures described in this chapter may not be applicable to every audit organization, but the principles and objectives remain mandatory. The word "should" is used to denote the desirability of an action. If followed, the procedures will implement satisfactorily the policies and standards which apply. The DoD internal audit organizations will be measured on their performance in relation to internal audit standards and policies.

2. Since the provisions of this manual are applicable only to the DoD internal audit organizations, other policies requiring wider cooperation between all the DoD audit, inspection and investigative elements will be published in a forthcoming DoD Directive.

C. DOD INTERNAL AUDITING STANDARDS

The DoD internal auditing standards concerning coordination are as follows:

660 Coordination - The internal audit organization shall coordinate its activities internally and with other components of government to ensure effective use of available resources.

1. In planning work to be performed, the internal audit organization shall coordinate with agency management to ensure management needs are considered appropriately.
2. The internal audit organization shall minimize unnecessary duplication of audit work by coordinating the nature and scope of their audits and reviews with other DoD audit, investigation, and inspection groups.
3. Audit plans shall be exchanged among DoD internal audit organizations. Also, the internal audit organization shall meet with the appropriate GAO officials to exchange and discuss tentative audit plans for the next fiscal year. If overlapping or duplicative coverage is indicated, every effort shall be made to resolve it.



4. Upon beginning an audit, the audit staff shall seek information concerning other audits and reviews that have been performed of that activity or program.
5. The audit staff shall be alert to problem situations that may affect other DoD Components or Federal agencies. When such situations arise, the internal audit organization shall coordinate with others involved so that, when appropriate, one audit may be performed to fulfill the requirements of all.

#### D. POLICY

1. The Inspector General Act of 1978, as amended (reference (a)), directs the IG, DoD to give particular regard to the activities of the internal audit, inspection, and investigative units of the Military Departments with a view toward avoiding duplication and ensuring effective coordination and cooperation.

2. Office of Management and Budget Circular A-73 (reference (b)) contains the principle that "...audit effectiveness is enhanced by audit coordination." Under the provisions of reference (b), Federal audit organizations are required to coordinate and cooperate with each other in developing and carrying out their respective audit plans. Effective coordination requires continuous liaison; the exchange, when appropriate, of audit techniques, objectives, plans, working papers, and audit results; and the development of audit schedules to minimize the amount of audit effort required.

3. The provisions of reference (b) have been implemented in DoD Directive 7600.2 (reference (h)). The DoD internal audit organizations shall coordinate and cooperate with each other and with other DoD audit, investigative, inspection, and management review groups to ensure effective use of audit resources, preclude unnecessary duplication or overlap of review efforts, and permit efficient oversight of DoD programs and operations. The DoD internal audit organizations also shall coordinate and cooperate with the GAO and non-Federal audit organizations where there is a common interest in the programs subject to audit.

4. Coordination shall be a continuing effort and not merely an after-the-fact reaction to a potential scheduling problem. The degree of formal coordination depends, in part, on the relative size of the audit organization and its placement within a DoD Component. Although coordination is most important for large scale, multilocation audits because of the significant amount of planning, resources, and time they require, coordination of all review efforts shall be the general rule rather than the exception.

5. Coordination shall begin as early in the audit planning process as practical because coordination, especially during the audit planning phase, can save valuable time and effort. Coordination includes sharing technical information about audit approaches and techniques, exchanging audit results, and cooperating in joint training efforts.

6. When overlapping or duplicative coverage is indicated, the DoD internal audit organizations shall try to resolve conflicts.

## E. RESPONSIBILITIES

1. Every organizational level within the DoD internal audit organizations should coordinate review efforts and exchange information. Specifically, coordination and cooperation should be exercised between the following:

a. The DoD internal audit activities and the GAO. The GAO frequently uses published audit reports during surveys to either direct their efforts to areas not previously covered by DoD audit organizations, or to rely on published findings instead of performing review work of their own.

b. The Military Department audit agencies and the Office of the Assistant Inspector General for Auditing (OAIG-AUD), OIG, DoD. Coordination in the early planning stages of each audit is especially important since both activities conduct audits within the same DoD Component.

c. The Military Department audit agencies concerned and other Military Department audit agencies. Coordination is important because audits in one Military Service may disclose conditions that could be affecting operations adversely in other Components.

d. The Military Department audit agencies and the internal review elements within their respective DoD Component. Internal review activities often provide an audit liaison service for their organizations, in addition to their principal mission of serving commanding officers in ensuring sound management practices and procedures are observed within their organization. Consequently, this level of coordination is essential to effective audit work by the various internal and external audit staffs.

e. The Military Department audit agencies and the Military Department inspector general organizations. With the increasing use of systemic inspection techniques, the headquarters levels of Military Department inspector general organizations are undertaking broader, more indepth reviews similar to the multilocation audits of the internal audit activities.

f. The Military Department audit agencies and the Military Department criminal investigative agencies. Starting or continuing an audit in an area where there may be an ongoing investigation is a matter for careful consideration.

g. The OAIG-AUD, OIG, DoD, and the Offices of the Assistant Inspectors General for Inspections, Investigations, and Audit Followup.

h. Resident auditors, inspectors, internal reviewers, and investigators at major command levels, as well as those at installation level. Although procedures for coordinating in areas of mutual interest may be less formal than coordination procedures used at the central headquarters of the major review activities, cooperation and effective working relationships are equally important at local levels.

i. The DoD internal audit organizations and the Defense Contract Audit Agency (DCAA). When performing reviews of the procurement function, internal audit organizations may require the assistance of DCAA to evaluate contracting and contract administration activities.

2. Coordination extends beyond merely exchanging audit schedules with other review groups and providing audit reports upon request. Coordination also involves establishing close liaison and good working relationships with other DoD review groups, external review groups, and DoD managers. To promote the most efficient use of resources among the members of the inspector general community and to ensure that the efforts of each review group complement rather than duplicate each other, each DoD internal audit organization should establish programs to accomplish the following:

- a. Meet with counterparts on a regularly scheduled basis.
- b. Exchange audit plans and schedules.
- c. Exchange information on technical matters, including audit programs.
- d. Obtain input on suggested areas for audit.
- e. Ensure management's needs are considered in establishing audit priorities.
- f. Suggest areas for inspection or investigation.
- g. Provide access to internal audit and, with command approval, internal review reports.
- h. Distribute copies of audit announcements, when applicable.
- i. Exchange information on prior audit coverage and review results.
- j. Request audit assistance from other review groups, as necessary.
- k. Be alert to problems that may affect other agencies and, when such situations arise, coordinate with others involved to see if a single review can satisfy all requirements.

#### F. RESOLUTION OF POTENTIAL CONFLICTS

1. The DoD internal audit organizations should establish formal procedures to accomplish the following:

- a. Identify the review efforts of other DoD and Federal review groups.
- b. Ascertain whether the possibility of a scheduling conflict or duplication of effort exists.
- c. Resolve any issues raised during the coordination process.

d. Respond, in a positive manner, to the coordination efforts of other review groups. As an example, when a DoD internal audit activity receives a schedule or specific announcement of a review from another review group (for example, GAO, OAIG-AUD, Inspection, etc.), they should send the document to the appropriate offices within their organization. The offices should be required to review the information and report back to a central point (possibly the planning office) that either (1) no potential duplication exists, or (2) if a problem was noted, action was taken to resolve the problem.

NOTE: Close, effective liaison with other review groups will help audit organizations identify potential scheduling conflicts and indications of duplicative audit work.

2. The DoD internal audit organizations should resolve problems promptly when coordination indicates the following:

a. Potential conflict exists with respect to a scheduled or ongoing audit review.

b. The scheduling of an audit may be inappropriate or untimely.

c. The results of a previous review could be used to satisfy the audit requirement or reduce the scope of an audit.

NOTE: Resolution may include (1) agreeing to meet and coordinate the review efforts, etc; (2) rescheduling the review of either organization by mutual consent; (3) providing audit information to the other party that could reduce or modify the scope of audit coverage; (4) documenting the need for overlapping audit effort; or (5) elevating the problem to a higher level when agreement cannot be reached.

3. The nature of coordination between internal review and military exchange audit activities to identify and resolve conflicts may vary with the size of the organization and with the degree of centralization or decentralization of operations. However, smaller audit organizations are still responsible for avoiding duplication and for notifying other groups when their reviews may duplicate or overlap other reviews. Internal review activities that provide liaison with auditors or other reviewers are uniquely positioned to identify conflicting efforts and to help promote coordination.

#### G. COORDINATION PROCEDURES AND PRACTICES

1. During the coordination process, the following information on audit subjects normally should be provided in sufficient detail to clearly identify the area to be audited:

- a. Title of the audit review and the project number.
- b. Purpose and objectives.
- c. Scope of the review.
- d. Timing of the review.
- e. Locations, organizations, and programs to be reviewed.
- f. Contact point for further information.

2. On small audits it may not be feasible to coordinate routinely descriptive information, but the DoD audit organizations should make these data available upon request. In some instances, it may not be possible or practical to identify the specific audit locations and timing during the initial coordination process; however, this information should be identified and coordinated before beginning the audit application (verification) phase. When an audit is canceled or an audit survey indicates further audit work would be unproductive, the DoD audit organizations should notify management in a timely manner. Other participants in the original coordination process may be notified through publication of a revised audit schedule periodically.

3. When overlapping audit and inspection efforts are identified during the initial coordination process, and all organizations involved continue their review efforts, the DoD audit organizations should arrange to exchange information on the results of the review with the other review organizations before releasing the report. This will ensure that differences in scope and objectives are clearly reported.

4. The DoD audit organization should establish procedures for referring problems more effectively handled by Military Department inspector general activities to the appropriate inspection organization. Certain problems, by their nature, are handled more appropriately by inspectors, while others are addressed more appropriately by auditors. Therefore, the exchange of information and recommendations about audits and inspections is mutually beneficial for both types of organizations and their respective Components.

5. The Military Department audit organizations should establish procedures for referring audit suggestions to the OAIG-AUD, OIG, DoD, if the audit subject applies to more than one DoD Component and can be addressed more appropriately by a DoD-wide audit. Conversely, the OAIG-AUD should establish procedures for referring audit suggestions to the appropriate Military Department audit organization when an audit problem has limited DoD-wide applicability.

#### H. RELATIONSHIPS WITH MANAGEMENT

1. Before beginning an audit, the DoD audit organizations should furnish the audit scope and objectives to appropriate managers in the activity under audit. Auditors should provide sufficient advance notice of the audit and observe the established chain of command during the coordination process.

2. Managers at local installations and intermediate command levels frequently conduct studies and analyses of internal operations. During the initial coordination process, auditors should determine whether any studies or analyses are planned by management in the proposed audit area, and review these plans and any studies that may have been completed recently. If unable to review management studies before beginning the audit, the auditor should contact management or the audit liaison office to obtain the studies upon arrival at the audit site. To the extent possible, the DoD audit organizations should reduce the scope of audit efforts based on the objectives, extent, and quality of the management review.

3. Internal auditors should make every effort to follow procedures prescribed by the activity under audit to coordinate the audit, to ensure the auditors' needs for information are communicated to responsible officials, and to ensure management's views are obtained as the audit progresses. When auditors need to contact operating personnel directly to expedite a review, auditors should notify appropriate management officials and explain the purpose and importance of the contact.

#### I. INTERNAL AUDIT RELATIONSHIPS WITH DCAA

The DoD internal audit organizations should coordinate all reviews involving contractor records with DCAA and with the appropriate contract administration office to avoid duplication of audit work. In addition, the DoD audit organizations should request the services of DCAA whenever data must be obtained directly from contractors or from working paper files maintained by DCAA. Requests should be in sufficient detail to avoid misunderstandings as to the objectives being pursued. Internal auditors may discuss requests with the local DCAA auditors but discussions should be confirmed subsequently in writing. (More specific guidance on this subject is contained in Contract Audit Policy Memorandum No. 1, reference (i)).

#### J. LIAISON WITH OTHER REVIEW GROUPS

1. The DoD internal audit organizations should recognize the complementary nature of the various types of review efforts and establish procedures for identifying review efforts completed, in process, or planned by other audit, investigative, and inspection review groups. Each auditor should determine the extent of work done by other review groups when planning audits. If the analysis of other work in the area indicates duplication or overlap, internal auditors should reduce the scope of the planned audit, cancel or postpone the audit, or build on the work already done in the area, as appropriate.

2. To determine the scope of work covered by another review effort, internal auditors may need to review audit working papers from another agency. The DoD internal audit organizations should provide access to other DoD internal audit organizations in the interest of avoiding duplication.

3. Whenever possible, auditors should meet with inspector general personnel to discuss their inspections of the area, obtain suggestions for the audit, and review inspection reports. If the audit is in an area that may be particularly conducive to fraud or serious abuse, or where a prior investigation may have been conducted, auditors should contact the local criminal investigative element to coordinate their work.

#### K. SHARING TECHNIQUES AND PROGRAMS

To optimize the use of resources, the DoD internal audit organizations should take advantage of audit techniques developed by others. Sharing audit techniques includes making maximum use of existing audit programs and guides to reduce the time and effort required to develop new programs for individual audit projects. To help audit organizations share audit programs, the OIG, DoD, publishes a Directory of Internal Audit Programs annually. The directory provides information on audit programs by organization and functional area, and provides directions for obtaining the programs. When researching and planning

an audit, DoD auditors should obtain copies of audit programs and guides covering the audit area and consider using them to develop the detailed audit plan. The DoD internal audit organizations also are strongly encouraged to interchange ideas related to the use of computers or other advanced techniques for audit.

L. TRAINING COOPERATION

Audit training also should be coordinated. The DoD internal audit organizations should determine the availability of training from other audit organizations and, if possible, make arrangements to have their staff attend training courses sponsored by other audit agencies. Sharing training promotes consistency in audits, fosters closer working relationships among audit organizations, and keeps auditors informed of developments in other audit organizations. Policies and guidelines relating to auditor training are covered in Chapter 4 of this manual.

CHAPTER 10  
AUDIT REQUIREMENTS GENERATED BY SOURCES EXTERNAL TO  
DEPARTMENT OF DEFENSE  
PART I  
INTRODUCTION

Many external forces impact on the roles and responsibilities of internal audit and internal review organizations within the Department of Defense. These include actions by the Congress, the Office of Management and Budget (OMB), the Comptroller General of the United States, and organizations within the professional audit community. This chapter provides policy and guidance on how to meet requirements imposed by external organizations. The various parts of this chapter describe specific requirements established by the IG, DoD to comply with legislative acts, OMB circulars, and other such authorities.

As specific requirements arise requiring implementing audit policies, these audit policies will be added to this chapter.



PART II  
INTERNAL CONTROL SYSTEMS

A. PURPOSE

Part II establishes policy for evaluating and reporting on DoD internal control systems under the Federal Managers' Financial Integrity Act of 1982 (reference (j)), OMB Circular No. A-123 (reference (k)), and DoD Directive 5010.38 (reference (l)).

B. APPLICABILITY

All DoD internal audit organizations including internal review and military exchange audit activities shall comply with applicable policy provisions in Part II.

C. DEFINITIONS

1. Internal Control Review. A detailed examination of a system of internal control to determine whether adequate controls are used to prevent or detect potential risks.

2. Internal Control Standards. Standards issued by the Comptroller General in June 1983 to help managers in all executive agencies establish and maintain effective systems of internal control, as required by the Integrity Act (reference (j)).

3. Internal Control System. The sum of an organization's plans, methods, and measures used to achieve the objectives of internal or management control described in subsection C.4. below. The internal control system encompasses both administrative and accounting type controls.

4. Internal (Management) Control. The plan of organization, methods, and measures adopted by management within the Department of Defense to (a) ensure compliance with applicable laws, regulations, and policies; (b) safeguard resources against waste, loss, unauthorized use, or misappropriation; and (c) ensure the reliability and accuracy of financial records, statistical records, and reports. Internal control includes administrative control and accounting control. Generally, administrative controls focus on program performance and the efficiency and effectiveness of operations. Accounting controls normally focus on traditional financial management areas. Internal control is referred to in DoD Directive 5010.38 (reference (l)) as "internal management control," but according to OMB, the terms "internal control" and "management control" are synonymous. Internal or management controls should be an integral part of each system (such as administrative, operations, and accounting) that management uses to achieve the objectives of agency programs, functions, and activities.

5. Material Weakness. A situation in which the designated procedures, or the degree of compliance with the designated procedures, do not provide reasonable assurance that the objectives of internal control enumerated in subsection C.4. above, are being achieved. See Appendix A for further information on material weaknesses.

6. OMB Guidelines. Guidelines issued by OMB in December 1982 in response to requirements in the Integrity Act (reference (j)). The OMB Guidelines (reference (m)) can help DoD managers to (a) develop specific plans for self-evaluations of internal control systems, (b) improve existing control systems, and (c) comply with the internal control reporting requirements imposed by reference (j).

7. Vulnerability Assessment. A review of the susceptibility of a program or function to waste, loss, unauthorized use, or misappropriation.

#### D. POLICY

1. Internal Audit Activities. The DoD internal audit activities normally shall evaluate internal controls in each area or function audited. On each scheduled audit, the audit activity also shall further evaluate management's implementation of the internal control program as it relates to the scope of the scheduled audit. Annually, each internal audit activity shall advise the Military Department, agency or activity whether the annual internal control evaluation performed by management complied with the OMB Guidelines (reference (m)). Each internal audit activity shall send a copy of the auditor's annual statement to the IG, DoD, by November 15 of each year. Internal audit activities are further encouraged to perform evaluations of internal control systems requested by their respective Department, agency, or activity and to provide, whenever practicable, technical assistance to further the overall DoD goal of strengthening internal control systems.

2. Internal Review and Military Exchange Audit Activities. Internal review and military exchange audit activities normally shall review and evaluate applicable internal control systems during every audit. These activities also may help the commander with the overall evaluation of internal controls and provide technical assistance to managers in their efforts to evaluate and improve internal controls. However, they shall not engage in activities that could impair their ability to assess independently the adequacy of management's internal control systems evaluations.

3. Training. All DoD internal audit organizations shall provide their staffs with adequate training on the evaluation of internal control systems, regulatory requirements governing internal control systems, and related roles and responsibilities of management and auditors.

#### E. BACKGROUND

1. The Federal Managers' Financial Integrity Act of 1982 (reference (j)). Reference (j) requires renewed focus on management's need to strengthen internal controls and directs the Secretary of Defense to do the following:

a. Establish a program for continuous evaluations of DoD systems of internal control.

b. Use OMB Guidelines (reference (m)) to evaluate these DoD systems of internal control.

c. Provide an annual report to the President and the Congress stating whether the DoD systems of internal control comply with the Integrity Act (reference (j)) and with the standards prescribed by the Comptroller General (reference (n)). If the controls do not comply fully, the report shall identify material weaknesses in the controls and specify plans for correcting the weaknesses.

2. OMB Circular No. A-123 (reference (k)). Reference (k) prescribes policy and standards for establishing, maintaining, evaluating, improving, and reporting on internal controls. In addition, reference (k) encourages the statutory inspectors general to assume certain responsibilities. These responsibilities include (a) providing technical assistance to help agencies evaluate and improve internal controls; (b) conducting reviews, either self-initiated or requested by management, of internal control documentation and systems; and (c) advising agency heads, upon request, whether the agency's process for evaluating internal controls complies with OMB Guidelines (reference (m)). The IG, DoD has adopted these responsibilities for the DoD internal audit organizations. DoD Directive 5010.38 (reference (l)), implements reference (k).

#### F. AUDIT COVERAGE AND ASSISTANCE

1. Efforts on Audit Coverage and Assistance. For discussion purposes, these audit efforts have been divided into four general areas: (a) regularly scheduled audits, (b) requested audits, (c) technical assistance, and (d) reviews of the adequacy of management's internal control evaluation, improvement, and reporting process. Each area is discussed in the subsequent paragraphs.

2. Regularly Scheduled Audits. Internal auditors shall, except in unusual circumstances, evaluate and report on internal controls during every audit, whether economy and efficiency or program results audits or financial and compliance audits (DoD Auditing Standard 450).

a. Evaluating Internal Control. The focus of the auditor's review of internal controls may vary with the type of audit. However, the basic purpose for evaluating internal controls during audits is always the same, namely, to determine the extent the auditor can rely on existing controls when planning the nature, extent, and timing of audit tests to be applied during the examination and verification phases of the audit. The review of the system of internal controls by the auditors can aid in devising better auditing procedures for evaluating the results of operations, or when appropriate, for formulating an opinion on the fairness of financial statements.

(1) Program Results and Economy and Efficiency Audits. Within the Department of Defense, economy and efficiency audits normally are performed as part of program results reviews. During these reviews, auditors shall evaluate the internal control system used by the organization, program, activity, or function under audit. Because controls encountered during program results and economy and efficiency audits generally will be administrative controls, the review shall focus on the policies, procedures, practices, and controls used by management to achieve program goals and objectives in the most economical manner.

(2) Financial and Compliance Audits. Except in unusual circumstances, auditors shall evaluate existing internal controls during all financial and compliance audits. These internal controls primarily will be accounting controls, that is, the plan of organization and the procedures and records used to safeguard assets and to make sure financial records are reliable. Auditors should be alert always to situations or transactions that indicate fraud, abuse, and illegal expenditures or acts.

(3) Auditing Computer-Based Systems

(a) When auditing computer-based systems, the auditor shall review both general controls in the data processing system and application controls of the installed data applications. These reviews shall comply with DoD Auditing Standard 460 and follow guidance outlined in Chapter 9, "Auditing Computer-Based Systems."

(b) Auditors shall determine whether all built-in controls are documented properly and tested adequately by the activity.

b. Evaluating Implementation of Internal Control Program. As part of or in addition to evaluating internal controls described in paragraph F.2.a. above, each DoD internal audit activity will evaluate how well management has implemented the internal control program requirements of OMB Circular No. A-123 (reference (k)) and DoD Directive 5010.38 (reference (l)) as it relates specifically to the scope of the scheduled audit. This would include reviewing especially the adequacy of the vulnerability assessments and internal control reviews in those areas in which the auditors identify internal control weaknesses.

c. Reporting Internal Controls

(1) Each audit report, whether as a result of program results, economy and efficiency, financial and compliance, or computer-based systems audit, shall describe the auditor's evaluation of applicable internal controls and shall summarize the audit results. For financial and compliance audits, this statement on internal accounting controls shall also identify the entity's significant internal accounting controls; controls identified that were evaluated; and controls identified but not evaluated. If internal controls are not evaluated, the audit report shall explain why the controls were not evaluated. Any material weaknesses identified in internal controls shall be included and identified specifically in the audit report and also brought to the attention of the senior management official responsible for the activity's internal control program.

(2) Each audit report also shall summarize the audit results on how well management had implemented the internal control program as it related to the scope of the scheduled audit.

### 3. Requested Audits

a. Occasionally, managers may ask audit organizations to review aspects of their internal control systems. These reviews may be made separately or performed in conjunction with regularly scheduled audits. Based on the request, the audit activity shall establish specific audit objectives to guide the audit effort and to address the specific concerns of management.

b. When audit activities agree to conduct internal control reviews, the Military Department, agency, or activity heads may rely on the audit results in preparing their annual statements to the Secretary of Defense. However, the Military Department, agency, or activity heads still are responsible for the overall judgments made in the annual statements.

### 4. Technical Assistance

a. Although the DoD internal audit activities perform audits and reviews as discussed in subsections F.2. and F.3., above, and F.5., below, they are not precluded from providing technical assistance to managers in their efforts to evaluate and improve internal controls. In fact, audit activities are encouraged to provide technical assistance to further the overall DoD goal of strengthening internal control systems.

b. However, since management has primary responsibility for maintaining a strong system of internal control, managers throughout the DoD Components shall be heavily involved in internal control programs. Therefore, auditors shall exercise due care to avoid compromise of professional independence. Independence shall be maintained so audit opinions, conclusions, judgments, and recommendations are impartial, and will be viewed as impartial by knowledgeable third parties.

### 5. Review of the Adequacy of Management's Internal Control Evaluation Process

a. Auditors shall determine whether the agency's process for evaluating internal controls complies with OMB Guidelines (reference (m)), and advise management of the results of their assessment. As part of this assessment, the auditors should rely on the audit results obtained under the guidelines in subsection E.1., above. Additional audit work should be programed to the extent needed to support the annual statement required under subsection D.3. above, and paragraph F.5.b., below.

b. Based on the audit results, each internal audit activity shall submit a statement to management advising them of the adequacy of the agency's internal control evaluation process. The statement shall be prepared in the format shown in Figure 10-1. By November 15 of each year, each internal audit activity shall also send a copy of this statement to the IG, DoD. The IG, DoD, uses these reports to advise the Secretary of Defense on the overall adequacy of the evaluation process within the Department of Defense.

G. INTERNAL REVIEW AND MILITARY EXCHANGE AUDIT ACTIVITIES

1. DoD Directive 7600.2, (reference (h)) allows internal review and military exchange audit activities to help managers evaluate the adequacy of vulnerability assessments and internal control reviews. However, these audit activities shall refrain from doing vulnerability assessments or internal control reviews because they are management's responsibility. Such involvement would impair independence (DoD Auditing Standard 100) and could prevent the audit activities from providing objective, independent evaluations to management.

2. These audit activities are, however, encouraged to provide technical assistance to help managers evaluate and improve internal controls, including assisting managers in training their staff.

H. TRAINING

1. The audit activities shall provide training for their auditors consistent with DoD Auditing Standard 200 on professional proficiency and continuing education. Training should focus on regulatory requirements, definitions, and standards pertaining to internal control systems, and on the related roles and responsibilities of managers and auditors with respect to internal controls.

2. Internal control training should, at a minimum, include the following:

a. Refresher training on basic internal controls, including methods for determining whether such controls exist and techniques for testing and evaluating their effectiveness.

b. Basic requirements of OMB Circular No. A-123 (reference (k)), the Integrity Act (reference (j)), the OMB Guidelines (reference (m)), the GAO Internal Control Standards (reference (n)), and DoD Directive 5010.38 (reference (l)).

c. Roles and responsibilities of auditors and managers under the Federal internal control program.

d. Techniques for evaluating management's implementation of OMB Circular No. A-123 (reference (k)). Training should include how to make vulnerability assessments and conduct internal control reviews.

3. Similar training shall be provided to the staffs of internal review and military exchange audit activities, whenever possible.

MEMORANDUM FOR (agency or activity head)

SUBJECT: Statement on Internal Control Systems

We have conducted a review to determine whether the (agency or activity) has evaluated their system of internal accounting and administrative control for the year ended (date) in a reasonable and prudent manner and in accordance with the Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government, issued by the Director, OMB. During this review, nothing came to my attention that would indicate that the (agency or activity) did not comply with the OMB Guidelines.\* The scope of our review and support for our conclusion are shown in the enclosure.

(signature)

\*If this statement cannot be made, revise to highlight major deficiencies.

Figure 10-1. Format for Audit Statement to Agency or Activity  
on Adequacy of Management's Internal Control Review

PART III  
ACCOUNTING SYSTEMS

(This part of Chapter 10 is undergoing a complete revision because of the requirements contained in OMB Circular A-127. It will be forwarded for comment/staffing at a later date.)



CHAPTER 14  
QUALITY ASSURANCE PROGRAMS

A. PURPOSE

This chapter describes the essential elements of quality assurance programs, including applicable professional standards and responsibilities, and prescribes policy for establishment of such programs in DoD internal audit organizations.

B. APPLICABILITY

The provisions of this chapter are mandatory for all DoD internal audit organizations, including internal audit, internal review, and military exchange audit activities; and for the offices that provide oversight and program direction of the internal review functions of the Army, Navy, Marine Corps, and Defense Logistics Agency.

C. QUALITY ASSURANCE STANDARDS

Pertinent excerpts from the DoD internal auditing standard (Chapter 2 of this manual) follow:

690 Quality Assurance - Each internal audit organization shall establish and maintain a quality assurance program to ensure that work performed adheres to DoD auditing standards, policies, and procedures; conforms to internal regulations; and is carried out economically, efficiently, and effectively.

1. A quality assurance program shall include the following elements:
  - a. Supervision
  - b. Internal reviews
  - c. External reviews
2. Supervision of the work of auditors shall be carried out continually to ensure conformance with auditing standards, organization policies and procedures, and audit programs.
3. Internal reviews shall be performed periodically by members of the audit staff to appraise the quality of the audit work performed. These reviews shall be performed in the same manner as any other internal audit.
4. External reviews shall be performed to appraise the quality of the internal audit organization's operations. These reviews shall be performed using guidelines published by the Office of the Inspector General (OIG), DoD.

Such reviews shall be conducted at least once every 3 years. On completion of the review, a formal written report shall be issued. The report shall express an opinion as to the organization's compliance with the DoD auditing standards and, as appropriate, shall include recommendations for improvement.

#### D. POLICY

1. To maintain the confidence and trust of DoD management, the Congress, and private citizens, DoD auditors shall provide objective, reliable, timely, and professional audit products. The value of the services provided by DoD auditors is related directly to the quality of the audit work performed. In addition, the professionalism of DoD auditors is critical to acceptance and use of their work by DoD managers in improving and strengthening DoD programs and operations.

2. Each internal audit organization shall have a viable and effective quality assurance program that provides reasonable assurance to parties inside and outside the Department of Defense, that DoD auditors comply with generally accepted auditing standards, policies, and procedures. The quality assurance program shall incorporate the following elements:

a. Supervision. The DoD internal audit organizations shall establish a supervisory process which ensures audits are planned and completed in accordance with generally accepted government auditing standards and DoD internal auditing standards. The supervision process shall ensure that audit work is supported by clear, demonstrable, and objective evidence that is documented in audit working papers.

b. Internal Quality Control Reviews. Each DoD internal audit organization shall establish procedures to evaluate the adequacy and effectiveness of the audit organization's policies and procedures, and to determine whether audit work meets DoD internal auditing standards and policy. As a minimum, internal audit organizations shall periodically conduct management reviews of selected audits, organizational functions, or processes within the audit organizations, and issue a formal report which specifically addresses each review objective. Recommendations in the report shall be tracked until fully implemented or otherwise satisfactorily resolved. Working papers shall be prepared and retained to document all aspects of the internal quality control program and shall be made available for review by an external quality assurance review team.

c. External Quality Assurance Reviews. Quality assurance reviews of the DoD internal audit activities shall normally be conducted by the Office of the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD, with the assistance of representatives from the DoD internal audit organizations. The DoD internal audit activities shall conduct quality assurance reviews of the internal review and military exchange audit activities for which they have audit cognizance. Generally, OIG, DoD, will limit its external quality assurance reviews of internal review and military exchange audit activities to assessing how well the internal audit activities carried out their external reviews. Quality assurance reviews shall evaluate whether the DoD internal audit organization operates in an economical, efficient and effective manner and adheres to generally accepted government and DoD internal auditing standards,

policies and procedures. The final report on the quality assurance review shall be issued to the head of the audit organization reviewed, and to the IG, DoD. The DoD internal audit organizations shall cooperate fully with the quality assurance review team and respond promptly to all requests for information from the team.

d. The following sections elaborate on each of the three essential elements described above, and provide suggested guidelines and criteria for incorporating their use into an overall quality assurance program.

#### E. SUPERVISION

Supervision is the first step in a quality assurance program and it is a continuing process on all audit assignments within an audit organization. Responsibility for all audits remains with the head of the audit organization. However, the head of the audit organization may delegate audit tasks to audit managers or supervisors, who in turn may delegate these tasks to audit teams. Delegation requires that audit managers at all levels establish methods that ensure audit assignments are planned, controlled, and directed properly. The degree of control may vary among audit organizations and audit assignments.

1. Proper supervision of audit assignments is the most important element of an effective quality assurance program. To supervise effectively, supervisors should be involved in every phase of the audit, from planning to the final report. Supervisors should make sure auditors understand, without ambiguity, the nature, scope, content, and timing of the work assigned to them and the expected end product. Supervisors should review progress periodically on audit projects to determine whether jobs are on schedule and executed in accordance with plans. Supervision should be sufficient to make any required mid-course corrections without disrupting the audit assignment.

2. The actual amount of supervision required may vary based on availability of resources, complexity and sensitivity of audit work, and staff experience. However, supervision should be exercised at each level of the organization and for each level of task responsibility. Most audit assignments include the following phases: interaction, planning, survey, audit performance or application, and reporting. During these phases, supervisors should concentrate on the following:

a. Interaction. To ensure quality audit performance and efficient use of resources, supervisors should be aware of other audit projects within the audit organization and in other Federal audit activities. Supervisors should maintain open lines of communication with the headquarters of the audit organization and with other field offices in the organization. The objective of open communication is to reduce the overlap of audit projects and enhance the quality of audits. Supervisors should share ideas on audit design, audit planning, audit survey scope and techniques, audit objectives, audit approaches, training needs and audit workload.

b. Planning. Supervisors should establish the overall direction of the audit effort; determine the best use of available resources; establish goals and objectives for audits that make sure programs, activities, and

segments of agency operations are covered adequately; and coordinate audit effort with review efforts of other activities such as the military inspector general offices.

c. Survey. Supervisors should approve the survey approach, estimate time required for the survey, and establish milestones for review of survey results.

d. Program. After reviewing survey results, supervisors should set overall objectives, identify the steps or segments requiring further audit work, and determine any program modifications needed to fulfill the audit objectives. Supervisors should also estimate the time required for the detailed audit review and establish milestones for review of the program development.

e. Audit Performance

(1) Project Reviews. Supervisors should review audit projects periodically to make sure they meet DoD internal auditing standards. Supervisors should use onsite visits to assist in project management, solve specific problems during audit application, provide technical assistance, counsel and train audit team members, and review overall management of the audit.

(2) Reviews of Working Papers. Supervisory reviews of audit working papers are essential to ensure reports are supported with clear, demonstrable, and objective evidence. These reviews can be tailored to the particular situation and individual, but should provide enough information to supervise projects properly and to evaluate staff performance. Problems discovered during working paper reviews should be discussed and resolved promptly; working papers should be revised to preclude any misinterpretation or unsupported conclusions. Working papers should be reviewed periodically throughout the audit. All supervisory reviews of working papers should be documented and retained. Chapter 8 of this manual prescribes additional guidance on the preparation and review of audit working papers.

f. Reporting. Auditors should prepare a report outline and discuss preparation of the initial draft report with their supervisor. First-level supervisors should review the draft audit report and second-level supervisors review comments and the results of any discussions with management concerning the audit results. Based on these reviews the second-level supervisor finalizes the draft audit report, making sure the audit report complies with the DoD internal auditing standards on reporting.

F. INTERNAL QUALITY CONTROL REVIEWS

Quality control reviews, the second step in an effective quality assurance program, are periodic reviews of selected audits, organizational functions, or internal processes, conducted by an independent element within the audit organization. During the quality control review, an in-house team evaluates the adequacy and effectiveness of the audit organization's policies and procedures, and determines whether the audit work meets DoD internal auditing standards and policy. During a typical quality control review, the review

team visits the applicable directorate, division, region, field office or resident office. Other audit sites may be visited, depending on the scope of the review. During the visits, the review team forms an overall opinion of the adequacy of the area(s) being reviewed and determines whether improvements are necessary.

1. Each audit organization should establish policies, procedures, and plans for accomplishing quality control reviews. Each major element of the audit organization should receive a quality control review at least once every 3 years. Major elements include divisions, regions, large field offices or residencies. As an alternative, selected functional areas may be reviewed on an across-the-board or agency-wide basis, provided there is representation given to the various elements within the organization. The quality control review should emphasize matters relating to the accomplishment of audit projects; that is, preplanning, survey, and field work, including preparation of working papers and reporting.

2. Quality control review techniques should be tailored to meet the specific situation. A review may include all functional elements of an organization, only one element, or several elements at one time.

3. The audit organization may use several teams or a permanent quality control staff to fulfill the quality control requirement. When selecting a staffing alternative, the audit organizations should consider the qualifications needed to accomplish the review, composition and size of the team, training and continuity of reviews, independence, and geographical and travel constraints.

4. The quality control review team should adhere to DoD internal auditing standards. The team should document all conditions found during the review process and issue a formal report that specifically addresses each review objective. The report should recommend corrective actions, when appropriate; include comments from the organizational elements reviewed followed by an evaluation of the comment by the quality control review team; and establish target dates for implementation. Recommendations should be tracked until fully implemented or otherwise satisfactorily resolved. When significant deficiencies are identified, a followup review may be appropriate to determine that adequate corrective actions were taken.

5. All working papers and reports of internal quality control reviews should be retained for 3 years for use by external quality assurance review teams.

#### G. EXTERNAL QUALITY ASSURANCE REVIEWS

Quality assurance reviews are similar to quality control reviews, but they are conducted by groups external to the audit organization. Within the Department of Defense, quality assurance reviews of internal audit activities will normally be conducted by the Office of the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD, with the assistance of representatives from the DoD internal audit or internal review activities. The DoD internal audit activities, using guidelines published by OIG, DoD, are responsible for quality assurance reviews of the internal review and military exchange audit activities for which they have audit cognizance. Occasionally, however, the GAO may conduct similar quality assurance reviews of DoD audit organizations.

1. The objectives of the external quality assurance reviews are to ensure DoD audit organizations adhere to DoD internal auditing standards, policies, and procedures, and operate in an economical, efficient, and effective manner.

2. Generally accepted auditing standards should be used in conducting these quality assurance reviews, in the same manner used in performing any audit. In particular, the team leader of the review should observe the requirement for holding entrance and exit conferences, and discussing periodically the progress of the review with appropriate managers in the audit organization.

3. Quality assurance review team members should be selected based on the requirements of a particular review. Functional experts from inside and outside DoD may augment the quality assurance teams in certain specialized or technical areas. The staff members nominated for the quality assurance review team should not have been associated in the past 2 years with the organization subject to review.

4. Before starting a quality assurance review, the review team should collect background information about the audit organization, including its organizational environment and governing policies and procedures. The review team is encouraged to use questionnaires to gather background data, identify related audit policies and procedures, obtain opinions of the audit staff on policies and procedures used by the audit organization, and solicit opinions of auditees regarding the relationships of the audit organization and its clients. The DoD internal audit and internal review activities should respond promptly to all requests for information from the quality assurance review team.

5. Quality assurance reviews should be conducted on a recurring schedule and normally should include each audit organization at least once every 3 years. As with any audit, the scope, objectives, and work program of the quality assurance review should be tailored to meet specific situations.

CHAPTER 17  
DOD INTERNAL AUDIT POLICY ADVISORY GROUP

A. PURPOSE

This chapter establishes a permanent internal audit policy advisory group to advise the IG, DoD, on internal audit policy matters within the Department of Defense.

B. APPLICABILITY

This chapter applies to all DoD audit organizations, including internal audit, internal review, and military exchange audit activities.

C. POLICY

1. Under DoD Directive 5106.1, "Inspector General of the Department of Defense" (reference (o)), the IG, DoD, is responsible for providing policy direction for internal audits of DoD programs and operations. Current DoD policies on internal auditing are contained in DoD Directive 7600.2, (reference (h)), DoD Instructions 7600.3, 7600.5 and 7600.6, (reference (p), (q), (r)) and in other chapters of this manual.

2. The Internal Audit Policy Advisory Group shall provide advice and assistance to the IG, DoD, on internal audit policy within the Department of Defense.

D. ADVISORY GROUP MEMBERSHIP

1. The chairperson of the advisory group shall be the Deputy Assistant Inspector General for Internal Audit Policy and Oversight, OIG, DoD, (DAIG-APO). Members of the Inspector General's audit policy staff will assist in presenting issues of current interest to the advisory group.

2. In addition to the DAIG-APO, each member organization shall appoint a representative to the advisory group who has direct access to the head of their audit organization. Each organization shall designate a primary member and an alternate, and shall notify the chairperson, in writing, whenever the primary or alternate representatives change. A representative from the Office of the Assistant Inspector General for Criminal Investigations Policy and Oversight (OAIG-CIPO), OIG, DoD, shall be a member of the group and provide advice on matters involving the interface between audit and investigation. The following organizations shall be represented on the advisory group:

- a. OAIG-AUD, OIG, DoD.
- b. Army Audit Agency.
- c. Naval Audit Service.
- d. Air Force Audit Agency.
- e. Army and Air Force Exchange Service
- f. Navy Resale and Services Support Office.
- g. Marine Corps Exchange Service.
- h. Army Internal Review.
- i. Navy Internal Review.

- j. Marine Corps Internal Review.
- k. Defense Logistics Agency Internal Review.

#### E. ADVISORY GROUP RESPONSIBILITIES

The policy group shall advise the IG, DoD, on all aspects of internal audit policy, and make recommendations for changes in those policies. Policy issues include, but are not limited to, management of audit organizations; technical audit standards; audit training and career development; and relationships with DoD managers, civilian professional associations, and other Federal agencies. The chairperson shall attempt to provide the members of the advisory group with an opportunity to comment on major audit issues being considered by the OIG, DoD, during the policy formulation process. Proposed draft audit policy documents generally will be forwarded to advisory group members of the various audit organizations for their comments and suggestions before official staffing of the documents with OSD, the Military Departments, and the Defense Agencies.

#### F. MEETINGS

The advisory group shall convene quarterly, or when determined to be necessary by the chairperson. An agenda generally shall be published in advance of meetings and representatives shall be given an opportunity to add topics or suggest changes to the agenda. Minutes shall be kept to ensure a record of important discussions and confirm agreements on any taskings. Distribution of the minutes shall be made to advisory group members before the next meeting.



EXPANDED DEFINITION OF MATERIAL WEAKNESS IN  
THE INTERNAL CONTROLS OF THE DEPARTMENT OF DEFENSE

A material weakness in DoD's system of internal controls may be due to lack of an appropriate control, or more frequently, inadequate compliance with existing controls. These controls deal with all program and administrative functions; they are not limited to financial or accounting matters. Regardless of what level a weakness in internal controls occurs within the Department of Defense, the Office of the Assistant Secretary of Defense (Comptroller) lists the following factors and examples for consideration in classifying or reporting a weakness as material:

- o Impairs fulfillment of mission.
- o Violates statutory or regulatory requirements.
- o Deprives the public of needed Government services.
- o Results in adverse publicity or embarrassment.
- o Diminishes credibility or reputation.
- o Endangers national security.
- o Leads to waste or loss of funds, property, or other resources.
- o Allows fraud or other criminal activity to go undetected.
- o Causes harm, even though minor individually, because they are extensive in the aggregate.
- o Causes loss of control over 5 percent or more of the resources for which an organization is responsible.

Because of the size and diversity of the Department of Defense and its Component organizations, material weaknesses are to be considered at four levels:

1. DoD Level.
2. Component Level.
3. Major Command or Field Activity Level.
4. Installation or Activity Level.

Listed below are some specific examples of the above factors applied at each of the four levels:

DoD LEVEL

(At the DoD level, a material weakness includes a problem that appears in several components, amounts to \$2 million or more, or may be national or international in scope. However, depending on the effect or impact of the problem, a less extensive problem could be of concern to the Secretary of Defense.)

- o Breakdowns in supply or repair policies and practices which result in too few ships, planes, vehicles, or weapons to accomplish intended missions.

- o Failure to observe controls over expenditure of funds within appropriation limits.
- o Poor medical care caused by inadequate procedures or insufficient resources.
- o Overpriced components of weapons systems (waste cans, toilet seat covers), or inappropriate overhead charges being tolerated from contractors.
- o Inadequate control over transfer of technology to foreign governments.
- o Insufficient attention to control over travel advances, or over interest penalty payments; small at each location, but pervasive throughout the Department of Defense.

#### COMPONENT LEVEL

(At the Component level, a recommended threshold for monetary problems in the larger Components is \$250,000. For small Defense Agencies, lesser thresholds may be appropriate.)

- o Problems which amount to losses of less than \$250,000, but which are pervasive, chronic, or constant.
- o Using funds from operations appropriations for procurement or construction purposes.
- o Using systems which do not conform with GAO principles and standards.
- o Inadequate control over access to records in computer data bases.
- o Improper practices in acquiring and maintaining computer equipment.
- o Failure to collect on debts owed the Government before members separate from service.
- o Poor control over property on hand or over property turned in as excess.

#### MAJOR COMMAND/FIELD ACTIVITY LEVEL

- o Inadequate control over maintenance versus new construction decisions.
- o Weaknesses in payroll practices.
- o Weaknesses in control over temporary duty travel.

INSTALLATION/ACTIVITY LEVEL

- o Inadequate performance by contracting officer representatives in user offices.
- o Failure to comply with controls over weapons, ammunition, or property.
- o Poor procedures for processing personnel on or off base.
- o Improper use of facilities or equipment.
- o Breakdown in controls allowing fraudulent actions in morale, welfare, or recreation activities.

The OMB, in its question and answer booklet dealing with the Federal Managers' Financial Integrity Act and Circular A-123 (reference (j) and (k)), provided the following guidance in reporting material weaknesses:

- o The material weaknesses included in the report to the President and the Congress should consist of matters of significance to the President and the Congress.
- o Assurance letters at other levels in an agency or organization probably will disclose weaknesses of varying degrees of significance to the agency as a whole. The recipient of the assurance letters at each level should collect and analyze those crosscutting weaknesses or items common to several units and other weaknesses of significance and consider whether they are appropriate for inclusion in the assurance letter to the next higher level official.

**END**

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